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PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA
ENERGY DIVISION
I.D.# 3515
RESOLUTION E- 3868
MAY 27, 2004

R E S O L U T I O N

Resolution E- 3868. San Diego Gas & Electric Company requests approval of renewable energy procurement contract with the San Diego County Water Authority. San Diego Gas and Electric Company's Advice Letter 1555-E is approved.

By Advice Letter 1555-E Filed on January 14, 2004.

SUMMARY

SDG&E requests Commission approval of a renewable energy contract to procure the output of a small hydroelectric facility.

San Diego Gas and Electric Company (SDG&E) filed Advice Letter (AL) 1555-E on January 14, 2004, requesting Commission review and approval of a renewable energy procurement contract with the San Diego County Water Authority (SDCWA). The contract would allow SDG&E to procure the electrical output of a 4.5 megawatt (MW) hydroelectric facility, producing between 10,000 and 20,000 megawatt-hours (MWh) annually. The contract price is \$53.70 per MWh, and the length is 10 years.

SDG&E demonstrated the contract confers price and other benefits in the ratepayers' interest. The PRG supported approval of the contract.

SDG&E made a sufficient showing that this contract is in the ratepayers' interest because it meets SDG&E's obligation to procure renewable resources under long-term contract at the price benchmark adopted in D.02-08-071. The members of SDG&E's Procurement Review Group (PRG) supported the approval of this contract.

AL 1555-E is approved effective today.

SDG&E requests that AL 1555-E be effective on January 14, 2004, or the date specified by the Commission in this resolution. AL 1555-E was not protested. This resolution approves AL 1555-E effective today.

BACKGROUND

The Commission provided guidance to the utilities on procuring renewable energy resources prior to full implementation of the Renewables Portfolio Standard (RPS) Program.

Decision (D.) 02-08-071 authorized the utilities to enter into procurement contracts between the effective date of the decision and January 1, 2003. The Decision adopted an interim reasonableness benchmark of 5.37 cents per kilowatt-hour for procurement contracts.

SDG&E filed renewable resource procurement contracts in Advice Letter 1445-E pursuant to the authority granted by D.02-08-071. The Commission approved those original contracts in Resolution E-3803. SDG&E has not issued a competitive solicitation nor signed any bilateral agreements other than the SDCWA contract since that time.

On August 13, 2003, the Assigned Commissioner in Rulemaking (R.) 01-10-024 issued a ruling, "Assigned Commissioner's Ruling Specifying Criteria for Interim Renewable Energy Solicitations" (ACR), which specified criteria for any further renewable energy procurement by the utilities prior to full RPS implementation. We stated in R.04-04-026 that we anticipate a solicitation conducted under the full suite of RPS parameters to occur by July 1, 2004.

The ACR set forth general process requirements:

1. A utility must abide by the terms of the Commission's first RPS implementation decision (D.03-06-071).
2. Utilities may engage in bilateral negotiations or may issue a competitive solicitation (request for offer (RFO)) to receive bids.
3. Issuance of an interim RFO by a utility does not constitute filing of a RPS procurement plan under the terms of D.03-06-071.
4. The utilities are allowed to "roll over" any under-procurement in 2003 into the Annual Procurement Target (APT)¹ for 2004 without penalty. A decision not

¹ The APT is the minimum amount of renewable generation the utility must procure each year to meet its RPS requirement, subject to the flexible compliance mechanisms authorized in D.03-06-071.

to issue an RFO prior to full RPS implementation will not waive this immunity. Conversely, any contract signed as a result of a bilateral negotiation or an RFO, and approved by the Commission, should count toward the APT.

5. Following PRG review of any proposed contracts, the utility may submit those contracts for Commission approval via Advice Letter.

The ACR also set forth criteria for interim procurement:

1. Any renewable procurement in the interim period must not anticipate the use of any Supplemental Energy Payments (SEPs) to be awarded by the California Energy Commission (CEC) pursuant to Public Utilities Code Sec. 383.5(d).
2. A solicitation must not anticipate the creation of the Market Price Referent (MPR) under development in the RPS process. Internal market benchmarks developed by the utility for bid evaluation are appropriate for preliminary evaluation, but should not be made public in the RFO or at any point in the solicitation process, and should not be referred to as the MPR.
3. Any internal benchmarks and details of their development should be provided to the Procurement Review Group (PRG) when the Preliminary Evaluation of submitted bids is performed, and to the Commission when any proposed contracts are ultimately submitted for approval.
4. Any RFO must clearly stipulate up front precisely how the utility will calculate adders for transmission upgrades and integration costs, and how the utility will assign capacity values and payments to as-available resources.

The RPS requires each utility to increase the amount of renewable energy in its portfolio, subject to requirements specified by the Legislature and the Commission.

The RPS Program, created by SB 1078 (Statutes of 2002, Chapter 516), requires each utility to increase the amount of renewable energy in its portfolio to 20 percent by 2017, increasing by a minimum of one percent per year. The Energy Action Plan (EAP) called for acceleration of this goal to reach 20 percent by 2010. R-04-04-026 encourages the utilities to procure cost-effective renewable generation in excess of their APTs for 2004, in order to make progress towards the goal expressed in the EAP.

In order for the output of a renewable resource to count toward a utility's RPS requirements, the resource must meet the requirements of an "eligible renewable energy resource" under the definitions of the program. New small hydroelectric

resources do not qualify for the program if they “will require a new or increased appropriation or diversion of water” as defined in California Water Code (Pub. Util. Code Section 399.12(a)(3).

R.04-04-026 established a framework for further implementation of the RPS Program, including establishing baseline quantities and 2004 procurement targets for the utilities.

As stated above, the RPS Program requires each utility to increase the amount of renewable energy in its portfolio to 20 percent by 2017, increasing by a minimum of one percent per year. The Commission establishes an APT for each utility, which consists of two separate components: the baseline, representing the amount of renewable generation a utility must retain in its portfolio to continue to satisfy its obligations under the RPS targets of previous years; and the incremental procurement target (IPT), defined as at least one percent of the previous year’s total retail electrical sales, including power sold to a utility’s customers from its DWR contracts. R.04-04-026 established an interim 2004 APT for SDG&E of 697.2 GWh to meet a 2017 target, and a generation target of 919.4 GWh to meet the 2010 target of the EAP.

SDG&E is interested in a bilateral agreement with SDCWA because the proposed project will meet SDG&E’s RPS requirements at a reasonable price and under reasonable terms.

SDG&E issued an RFP to meet grid reliability needs on May 16, 2003. As the SDCWA project will deliver as-available energy, it did not meet the requirements of SDG&E’s RFP for firm, dispatchable resources. SDG&E states that it is interested in SDCWA’s offer for several reasons:

1. It provides generation that will meet the requirements for an eligible renewable resource under California’s RPS;
2. The project is sited within SDG&E’s service territory;
3. The project, being a small hydro resource, provides SDG&E with an opportunity to further diversify SDG&E’s renewable portfolio;
4. The contract price of \$53.70/MWH (including Renewable Energy Credits) is consistent with the CPUC’s previously established benchmark for renewable purchases;
5. There is a high probability of project success because SDCWA is financially credible, the need for the pressure control facility is well established within SDCWA’s capital improvement plan, and the project’s commercial operation is not until December 2006;

6. SDG&E has right of first refusal to additional capacity if SDCWA upgrades the plant;
7. SDCWA must pay late pricing concessions if it does not come online by December 2006; and
8. The agreement does not require the use of Public Goods Charge (PGC) funds.² (SDG&E AL 1555-E, p. 2)

SDG&E further states that due to timing in project construction and the need to avoid delays in other portions of SDCWA's capital improvement program, SDCWA could not wait until SDG&E held a competitive solicitation under the RPS Program to sign a contract.

SDG&E's PRG participated in review of the contract.

In D. 02-08-071, the Commission required each utility to establish a "Procurement Review Group" (PRG) whose members, subject to an appropriate non-disclosure agreement, would have the right to consult with the utilities and review the details of:

1. Overall transitional procurement strategy;
2. Proposed procurement processes including, but not limited to, RFO; and
3. Proposed procurement contracts before any of the contracts are submitted to the Commission for expedited review.

The PRG for SDG&E consists of: the California Department of Water Resources, the California Energy Commission, the Commission's Energy Division, Natural Resources Defense Council, The Utility Reform Network, and Utility Consumers' Action Network. SDG&E discussed this contract with its PRG on December 16, 2003.

NOTICE

Notice of AL 1555-E was made by publication in the Commission's Daily Calendar. SDG&E states that a copy of the Advice Letter was mailed and distributed in accordance with Section III-G of General Order 96-A.

² The ACR required that no SEPs be used in pre-RPS solicitations. SEPs are a subset of the PGC funds collected from ratepayers.

PROTESTS

Advice Letter 1555-E was not protested.

DISCUSSION

The proposed contract with SDCWA includes the following terms: as-available hydroelectric power, capacity of 4.5 MW, priced at 5.37 cents per kWh, 10,000 kWh guaranteed minimum annual delivery, 10 years in length.

SDG&E provided three attachments to AL 1555-E: A) the Master Power Purchase and Sale Agreement, B) the Confirmation Letter, and C) a contract summary. We provide a brief summary here:

| Name of Project: Rancho Peñasquitos Pressure Control Hydroelectric Facility | |
|--|---|
| Contract Provision | Detail |
| Term | 10 years |
| Capacity | 4.5 MW |
| “Guaranteed minimum” delivery | 10,000 MWh annually |
| “Projected” delivery | 20,000 MWh annually |
| “Shall not exceed” delivery | 35,000 MWh annually |
| Product | As-available |
| Price | \$53.70 per MWh, “all-in” price, includes Renewable Energy Credits |
| Approximate value over term | \$5.37 million (at minimum delivery) \$10.74 million (at projected delivery) |
| Eligible renewable energy resource | Yes ³ |
| Delivery must commence no later than | 12/31/06 |
| Consequence of late online date | Unit price per MWh reduced by 10 percent if more than 3 months late |
| Scheduling coordinator | SDG&E |

Energy Division believes the concession for a late online date should be 10 percent of contract price during the first three months of delay, not zero percent as proposed in Exhibit F. The contract specifies a delivery date of no later than

³ As stated by SDG&E in Attachment C. See body text for discussion of RPS eligibility.

12/31/06. SDG&E has allowed a three month “grace period” under which there would effectively be no price concession or penalty, other than the filing by SDCWA of a remedial action plan (Exhibit A, Sec. 10.3d). However, due to the unintended delay in the approval of this resolution, we will approve the contract as proposed since the time covered by the concession has elapsed. This should be considered an exception and not a normative provision.

As discussed above, the ACR set forth criteria and process requirements for renewable energy procurement by the utilities prior to full RPS implementation. The proposed contract with SDCWA meets the requirements of the ACR.

Energy Division examined SDG&E’s request in AL 1555-E on multiple grounds: value to ratepayers conferred by the contract, SDG&E’s requirements under the RPS Program, and PRG involvement.

The proposed contract confers value to ratepayers because it meets the reasonableness threshold previously adopted by the Commission for renewables.

The contract price is 5.37 cents per kWh, which the Commission adopted as a reasonable pricing threshold for renewable contracts in D.02-08-071. The ACR did not adopt an interim benchmark, but instead allowed the utilities to develop their own benchmarks and apprise the Commission and the PRG of their derivation and use in evaluating contracts. SDG&E used the previously established benchmark in evaluating the proposed project bid. The ACR explicitly states that such a benchmark is not to be considered a MPR. The MPR is to be used in evaluating contracts under the RPS Program, and will not be available until the first RPS solicitation, which we anticipate no later than July 1, 2004. Therefore, Energy Division believes the 5.37 cent benchmark represents an appropriate threshold for evaluating this interim renewable contract.

No one can accurately predict long-term energy prices; renewable energy is no exception. We may find today that SDG&E has entered into a contract at a reasonable price, and then renewable energy prices may decline unexpectedly below our estimations in the long-term. Given that uncertainty, Energy Division has applied its best understanding of current renewable energy prices, estimations of future prices, and understanding of small-scale hydroelectric technology, and determined that the contract price provides value to SDG&E’s ratepayers that will continue into future years of the RPS Program.

The SDCWA facility must obtain certification from the CEC before we can find that its energy output counts toward SDG&E's RPS requirements.

As discussed above, a new small hydroelectric resource may only qualify for the program if they do not require a new or increased appropriation or diversion of water. Energy Division understands that the small hydroelectric facility under consideration does not require a new or increased appropriation or diversion of water. However, the CEC has established a process for pre-certification of renewable energy facilities for the RPS Program.⁴ SDCWA should obtain certification from the CEC that this resource is eligible for participation in the RPS program. We find the output from the SDCWA project will count toward SDG&E's RPS requirements (i.e. the APT for the year in which energy is delivered from the facility) once it obtains CEC certification.

In this resolution, we do not prejudice the development of a RPS Market Price Referent nor any other criteria for evaluating RPS contracts.

The MPR for RPS solicitations demarcates the portion of the contract price that will be paid to a successful bidder by the utility. Any remaining amount of the contract price not paid by the utility may come from SEPs awarded by the CEC. Nothing in this resolution prejudices the rules developed for the RPS Program in R.01-10-024 and R.04-04-026. Specifically, SDG&E's use of a 5.37 cents per kWh threshold for evaluating the SDCWA contract does not impact the Commission's development of an MPR for the RPS Program.

The PRG is supportive of the proposed contract.

The PRG was briefed on this contract on December 16, 2003. SDG&E notes in AL 1555-E that the PRG was "supportive of the agreement and terms." We clarify, however, that Energy Division reserved its conclusions for review and recommendation on the contracts to the resolution process. Energy Division had to review the contract independently, and allow for a full protest period before concluding its analysis.

⁴ See "Renewable Portfolio Standard Eligibility Guidebook," CEC Publication Number 500-04-002FD, available online: <http://www.energy.ca.gov/portfolio/documents>

COMMENTS

Public Utilities Code section 311(g)(1) provides that this resolution must be served on all parties and subject to at least 30 days public review and comment prior to a vote of the Commission. Section 311(g)(2) provides that this 30-day period may be reduced or waived upon the stipulation of all parties in the proceeding.

The 30-day comment period for the draft of this resolution was neither waived or reduced. Accordingly, this draft resolution was mailed to parties for comments, and will be placed on the Commission's agenda no earlier than 30 days from today.

FINDINGS

1. D.02-08-071 directed PG&E, SCE and SDG&E to file an Advice Letter to seek pre-approval of any contract for transitional procurement.
2. "Assigned Commissioner's Ruling Specifying Criteria for Interim Renewable Energy Solicitations," issued on August 13, 2003, specified criteria for any further renewable energy procurement by the utilities prior to full RPS implementation. The Ruling stated that a utility may submit renewable energy contracts for Commission approval via Advice Letter.
3. SDG&E filed Advice Letter 1555-E on January 14, 2004, requesting approval of a renewable energy procurement contract with the San Diego County Water Authority.
4. The RPS Program requires each utility, including SDG&E, to increase the amount of renewable energy in its portfolio to 20 percent by 2017, increasing by a minimum of one percent per year. The Energy Action Plan (EAP) called for acceleration of this goal to reach 20 percent by 2010.
5. A new small hydroelectric resource may only qualify for the RPS Program if they do not require a new or increased appropriation or diversion of water.

6. R.04-04-026 established an interim 2004 APT for SDG&E of 697.2 GWh to meet a 2017 target, and a generation target of 919.4 GWh to meet the 2010 target of the EAP.
7. The Commission required each utility to establish a Procurement Review Group (PRG) to review the utilities' interim procurement needs and strategy, proposed procurement process, and selected contracts.
8. The PRG for SDG&E is comprised of the California Department of Water Resources, the California Energy Commission, the Commission's Energy Division, Natural Resources Defense Council, The Utility Reform Network, and Utility Consumers' Action Network.
9. SDG&E's proposed contract satisfies the requirements of the ACR of August 13, 2003.
10. The contract price provides value to SDG&E's ratepayers.
11. The SDCWA facility must obtain certification from the CEC before we can find its energy output will count toward SDG&E's RPS requirements.
12. Nothing in this resolution prejudices the development of a RPS Market Price Referent nor any other criteria for evaluating RPS contracts.
13. The terms of the proposed contract are reasonable and should be approved.
14. AL 1555-E was not protested.
15. We should approve AL 1555-E effective today.

THEREFORE IT IS ORDERED THAT:

1. The request of the San Diego Gas and Electric Company to enter into a renewable energy procurement contract with the San Diego County Water Authority, as requested in Advice Letter AL 1555-E, is approved.
2. This Resolution is effective today.

I certify that the foregoing resolution was duly introduced, passed and adopted at a conference of the Public Utilities Commission of the State of California held on May 27, 2004; the following Commissioners voting favorably thereon:

WILLIAM AHERN
Executive Director